The trend in labour income since the beginning of the nineties

The level and structure of labour income are key economic variables. Together with pay-related taxes and levies, they are a crucial cost component for the enterprises and have a major impact on the level and composition of employment. Unsound developments in wage policy are likely to have been one of the causes of the persistent decline in employment since early 1991. How much market-funded employment is possible over the long term is determined not only by the trend in the level of pay but also by the spread and flexibility of the wage structure. In the interests of employment and incomes, collective pay settlements must leave enough leeway for that – especially as the link between pay increases and employment will emerge even more clearly than before in the planned European monetary union. In that respect, the new pay policy approaches of the past few years point in the right direction.

Pay rates statistics ...

The rates of pay negotiated between management and labour are of particular importance for labour income. For enterprises which are bound by the rules of collective pay agreements and for employees organised in trade unions, these rates of pay form the basis of the wages and salaries that are paid. The Bundesbank has been calculating an index of the negotiated wage and salary level in western Germany (including the remuneration of civil servants) since as long ago as the late fifties. Wage and salary index figures for eastern Germany were presented for the first time in August 1994[1]; their current trend since then and the agreed pay rates in the old Länder form an important basis for macroeconomic analyses and are published regularly in the Statistical Section of the Monthly Report.

... for Germany

At that time, calculating a combined index for Germany as a whole was not yet practical for a number of reasons. From an analytical point of view, separate regional indexes were necessary because of the wide difference, particularly in the first few years after German unification, in the levels of agreed pay rates between eastern and western Germany and, above all, their very different trends – a situation that was characterised by efforts to bring the lower east German pay rates into line with comparable west German standards as quickly as possible. Additionally, for several years after German unification there was a lack of reasonably reliable figures on the number of employed persons in many east German wage-bargaining areas; the number of employed persons is required by the weighting system for calculating the indexes of the negotiated wage and salary level. Moreover, the east German pay rates statistics at that time covered roughly 50 % of employees – a level that was significantly lower than in the old Länder, where the figure is around two-thirds. Now that these gaps have been filled, it is possible for the first time to publish figures for the pay rates statistics in the currency area as a whole.

Agreed pay rates in western and eastern Germany

Agreed pay rates

Calculated on that basis, between 1991 and 1996 agreed wages and salaries (including negotiated benefits such as holiday and Christmas bonuses) went up by a total of almost 30 % on a monthly basis, or 5 ½ % annually, in Germany. During that period, steep rises in negotiated pay of almost 11 % in 1992 and 6 ½ % in 1993 were followed by agreed pay increases levelling off to 2 ¼ % last year.

Those figures conceal wide regional variations. At an annual average of 13 ½ %, the rise in agreed rates of pay was almost four times higher in eastern Germany than in the old Länder. With the accelerated adjustment to near-parity or parity with west German pay rates brought about by the automatic cohesive pay bargaining system and phased agreements, those rates of growth in agreed pay rates fell from nearly 30 % in 1992 to 5 % last year. Between 1993 and 1996, management and labour in the old Länder agreed average monthly pay rises of 2 ¾ %, compared with 6 ¼ % in each of the two preceding years when the boost to economic activity triggered by German unification led to an increase in agreed rates of pay far in excess of the level called for in terms of anti-inflation policy and employment. Over that period as a whole, agreed pay rates rose by almost 4 % annually.

Negotiated working hours

In addition to the increases in agreed monthly rates of pay, employees benefited from a con-

1 For details, see "The trend in agreed pay rates and actual earnings since the mid-eighties", Monthly Report, August 1994, page 29 ff.

Agreed pay rates, actual earnings and labour costs in the overall economy *

Change from previous year in %

Year	Negotiated wage and salary level		Wages and salaries per employee	Wage drift 1	Compensation per employee	Memo item	
	On an hourly basis	On a monthly basis				Gross domestic product at 1991 prices per employee	Labour costs per unit of value added 2
	Western Germany						
1991	6.8	6.3	5.9	– 0.4	5.9	2.5	3.3
1992	6.4	6.3	5.8	– 0.5	5.9	0.8	5.0
1993	4.5	3.7	2.9	– 0.8	2.7	– 0.5	3.3
1994	2.1	1.7	2.0	0.2	3.2	3.3	– 0.1
1995	4.0	3.7	3.1	– 0.6	3.6	2.1	1.4
1996	2.3	1.9	2.0	0.0	2.2	2.4	– 0.2
1997 1st half	1.3	1.4	1.4	0.1	2.3	3.4	–1.1
	Eastern Germany						
1991	.	.	.	.	.	.	.
1992	31.7	29.4	37.2	6.1	37.6	23.6	11.3
1993	19.2	18.4	15.7	– 2.3	15.0	12.3	2.4
1994	9.4	8.7	6.1	– 2.4	6.8	7.7	– 0.8
1995	8.3	7.5	6.1	– 1.4	6.0	4.1	1.8
1996	5.2	5.0	2.9	– 2.0	3.4	3.8	– 0.3
1997 1st half	3.4	3.2	2.8	– 0.5	3.8	4.6	– 0.8
	Germany						
1991	.	.	.	.	.	.	.
1992	11.8	10.9	10.5	– 0.4	10.6	4.1	6.2
1993	7.5	6.5	4.6	– 1.8	4.3	0.6	3.7
1994	3.4	2.9	2.4	– 0.5	3.5	3.4	0.1
1995	4.6	4.3	3.5	– 0.8	3.9	2.1	1.7
1996	2.6	2.3	2.1	– 0.2	2.4	2.6	– 0.1
1997 1st half	1.7	1.6	1.7	0.1	2.6	3.6	– 1.0

* Work-place concept; the data in the national accounts are provisional from 1995 onwards. — **1** Deviations of wages and salaries per employee from the agreed pay rates on a monthly basis. — **2** Compensation per employee divided by real gross domestic product per employed person.

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tinuing reduction of negotiated annual working hours. This is reflected in the pay rates statistics by correspondingly higher rates of growth in pay on an hourly basis. Forgoing increases in income that would otherwise have been possible in favour of more free time can be put at just over ½ percentage point annually in the period under review; negotiated working hours hence played an almost equally important role as they had done for western Germany between 1982 and 1990. As was the case for the pay component, the main reason for the continuing trend in the reduction in working hours was the rapid convergence between west and east. Between 1991 and 1996, negotiated annual working hours decreased by an annual average of 0.8 % in the new Länder, whereas the annual average in western Germany was 0.3 %; at 29 days, compared with 29 ½ days in the west, parity in the terms of the amount of holiday has largely been achieved. Weekly working hours, which had initially been 42 hours in east German firms, were adjusted downwards as in western Germany. Nevertheless, at 39 ½ hours, they were still around two hours more than in the west at the end of 1996.

Pay convergence between east and west

In several major branches of industry, the agreed basic rates of pay on a monthly basis in eastern Germany have now reached the same level as in the old Länder. This includes the iron and steel industry, the metal-working and electrical engineering industry, enterprises in the printing industry (with more than 50 employees), and private banking. In other sectors of the economy, such as insurance and the retail trade, full parity has been agreed for the coming year. In the light of continuing intense pressure for adjustment and the progressive erosion of the industry-wide wage bargaining system, the phased plan to raise east German pay rates to full parity with their level in western Germany as of October 1, 1997, which was agreed two years ago, was rescinded for the east German construction industry. Since spring of this year, the east-west pay ratio has been 93.8 %. With a ratio of 85 % since September 1, 1997, the public services – where, in contrast to other economic sectors, there is much less of a disparity between agreed pay rates and actual earnings – are in the middle range of the "adjustment scale". The clothing industry is in the lower range with an east-west ratio of around two-thirds. On average, the agreed basic rates of pay in eastern Germany in the first half of 1997 were hence roughly 90 % of those in the west. At the beginning of 1991, the differential in agreed pay rates was 53 %.

In negotiated benefits, too, east German arrangements have been rapidly adjusted to those in western Germany over the past few years, although this trend was much less pronounced than in the case of basic monthly rates of pay. In the new Länder, holiday and Christmas bonuses were increased between 1991 and 1996 from less than 60 % to 80 % of agreed monthly pay; in the old Länder, these two special payments, taken together, amount to roughly one full month's payment. Including the special payments in eastern Germany – which are not so extensive – this gives an east-west ratio of 86 % on average in 1996 (1991: 54 %). On account of the fact that negotiated annual working hours are just over 5 % longer in eastern Germany, agreed pay came to nearly 82 % of the west German level calculated on an hourly basis.

Wage policy: old patterns, new emphases

Sectoral wage structure

A traditional feature of the pay bargaining process in Germany is that the first agreement for a new period in one major wage-bargaining sector often has a "guideline function" which is largely followed by management and labour in the other industries with regard to the agreed increase in wages and salaries. Viewed over the long term, there hence tends to be only a quite moderate spread in agreed levels of pay between the sectors. Calculated on an hourly basis – a method of analysis which suggests itself on account of the differing trends in negotiated annual working hours in the individual economic sectors – agreed pay rates in western Germany went up by 4.3 % annually between 1985 and 1996. The sharpest increase among the major branches of industry was in the metal-working industry at an annual average of 4.8 %. The public services, the banking industry (both 3.7 % each), and mining (2.6 %) were at the lower end of the scale. Over the period as a whole and excluding the special case of mining, this gives a ½ percentage point difference from the overall average in each case.

Nevertheless, the sectoral wage rate structure has fanned out somewhat in western Germany, as is indicated by various statistics for measuring variability. It is striking, however, that there have been above-average rises in agreed pay rates in the producing sector (which is particularly exposed to international competition) in the nineties, too. Greater restraint in that respect would possibly have helped to preserve a greater number of cost-effective jobs in industry.

Wage differentiation

Furthermore, there was no great spread in negotiated pay rates within the economic sectors. Instead, the pay rate level – irrespective of differences in skills – was in some cases flattened out further by a disproportionately high increase in pay rates in the lower earnings groups. Moreover, with the exception of the construction industry, there was no further differentiation of the wage and salary groups within the lower pay groups. There remains a considerable need for action for the future in order to give mainly persons with comparatively few skills a better chance of being integrated into the primary labour market or, at least, to reduce the job insecurity which is especially high in that area.

New emphases in rates of pay and ...

On the other hand, the fact should not be overlooked either that over the past few years, given the backdrop of a sharp decrease in employment and declining membership in professional associations, management and labour in Germany have demonstrated greater flexibility both in agreed rates of pay and in negotiated working hours. As far as the agreed pay rates are concerned, the steps to promote employment that have been agreed so far include a whole range of different measures. In the chemical industry, for example, there has been the possibility since 1994 of taking on the long-term unemployed at a wage below the agreed rate. In the west German construction industry, the lower end of the pay rate grid was extended downwards especially for problem groups in the labour market and a new wage grade was set up. In the west German textile and clothing industry there has been a clause since 1996 allowing enterprises to suspend or lower agreed pay increases for a limited period in a difficult economic situation if, at the same time, no operational redundancies are made.

As part of the new arrangements for the continued payment of wages and salaries during illness, the size of the annual special payments in some wage-bargaining areas of the metal-working and electrical engineering industry has been linked to the sickness ratio. The trade unions secured acceptance of the continued full payment of wages and salaries during illness being protected by collective agreement, after Parliament had limited the minimum guarantee for the first six weeks of illness to 80 % of payments. In return, the Christmas bonus was reduced and a lesser increase was made in agreed pay rates.[2]

The introduction of a "payment corridor" in the west German chemical industry which can be used from January 1998 onwards is especially noteworthy. This will make it possible to lower the wages and salaries of all the employees of an enterprise by up to 10 % of the agreed rates of pay for a limited period. In contrast to other clauses allowing greater flexibility in pay that were negotiated hitherto, the main purpose of this is not solely to prevent redundancies in the short term but also to re-establish or maintain competitiveness and secure the location. A comparable arrangement has likewise been agreed in 1997 for the construction industry in the new Länder.

... working hours

The measures to introduce greater flexibility in working hours that have been agreed over the past few years can essentially be divided into three basic strategies. Firstly, in a number of economic sectors standard working hours can be spread so that they correspond more closely to operational requirements. The period during which negotiated hours have to be worked to meet the average requirement has been extended and is now generally one year. Secondly, there is the possibility of reducing or increasing weekly working hours within certain set periods. In the west German metal-working and electrical engineering industry, for example, weekly working hours can be reduced by up to five hours if the order situation is poor in order to secure employment; monthly wages or salaries are correspondingly lower. Thirdly, in the construction industry agreed weekly working hours are shorter in the winter months than in the summer.

Actual earnings and wage drift

Gross pay

Although pay agreements largely determine the level of gross wages and salaries, they by no means do so completely. Depending on the relative strength of the demand for labour, the wages and salaries that are actual-

2 In the final analysis, the new provisions did not so much affect the overall labour costs as the way in which they are structured in terms of directly work-related and less work-dependent components.

Trend in agreed pay rates * on an hourly basis in selected economic sectors

Western Germany; 1985 = 100

Economic sector	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Overall economy	104.2	108.4	112.1	116.5	122.9	131.2	139.6	145.9	148.9	154.8	158.3
Producing sector (excluding construction)	104.5	108.5	113.4	118.3	125.1	133.4	141.2	149.2	152.1	160.4	166.1
of which											
Mining	103.6	106.9	110.9	112.7	117.9	123.7	130.7	134.6	130.9	136.9	133.2
Iron and steel industry	102.3	106.6	109.3	114.1	117.4	126.1	132.4	138.2	139.5	147.1	152.8
Chemical industry	104.0	108.4	112.4	117.4	125.2	133.0	140.8	148.8	152.9	158.0	161.7
Metal-working industry	105.0	108.6	114.0	118.8	125.6	134.0	141.0	149.6	151.9	161.2	167.5
Textile industry	104.1	108.1	111.8	116.3	121.0	129.2	138.0	145.5	150.0	155.7	159.3
Clothing industry	104.3	108.8	112.6	117.1	121.4	131.1	139.2	145.5	149.3	156.1	159.4
Construction sector	103.2	106.3	110.1	113.8	123.2	131.8	140.3	150.5	154.7	160.2	163.7
Crafts (excluding construction crafts)	103.3	108.2	112.1	116.6	122.6	130.2	139.1	145.7	149.6	154.3	158.2
Trade	104.9	109.8	113.6	117.9	122.9	134.4	142.9	148.9	153.3	159.1	163.6
Wholesale trade including foreign trade	103.1	109.6	113.0	117.3	123.1	133.2	142.2	147.6	151.2	156.6	160.3
Retail trade	106.2	110.0	114.0	118.4	122.7	135.2	143.5	149.6	154.6	160.6	165.5
Banking industry	104.2	108.7	111.8	115.9	123.1	128.5	136.2	140.1	142.7	147.6	149.4
Insurance industry	103.2	109.8	113.4	117.6	121.9	130.9	138.0	143.8	147.0	152.3	154.4
Public sector	104.0	108.4	110.5	114.7	120.9	128.6	137.1	140.9	142.4	147.5	148.9

* Including ancillary benefits (holiday and Christmas bonuses plus benefits under the German Personal Asset Acquisition Act); recalculated from the original base 1991=100.

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ly paid differ from agreed pay rates in terms of their amount and their trend. This means that there is at least a certain corrective for labour costs at the level of the enterprise; it is not a substitute, however, for failure to maintain a sense of proportion in pay policy.

Wage drift

The wages and salaries per employee that were actually paid rose by an annual average of 4½% in Germany between 1991 and 1996; they were thus an annual ¾ percentage point lower than the agreed rates of pay (on a monthly basis). This negative wage drift – apart from other effects such as, say, an increase in part-time work or a reduction in overtime worked – may be assessed as an indication of too sharp a rise in agreed pay rates from the point of view of the enterprises, which they attempted to counteract by a reduction in payments above the agreed scale. In the new Länder, however, the room for manoeuvre needed for this was very limited or, in most cases, virtually non-existent. For that reason, even more than in western Germany, the only course open to the enterprises there was to relax strict adherence to pay settlements or explicitly forgo membership in an employers' federation. It was only these "stopgap solutions" which enabled the enterprises in the new Länder to limit the rise in actual earnings to a total of 34% between 1993 and 1996, and to contain the 45% surge in costs due to wage settlements.[3]

3 The statistically recorded positive wage drift in eastern Germany for 1992 is, on the other hand, primarily a reflection of the fact that the number of short-time workers was reduced by over 1.2 million compared with the previous year (1991), in which there had been a massive increase in short-time working.

Actual earnings east/west

Average actual earnings in eastern Germany have therefore not drawn as close to the west German level as the agreed pay rates. The corresponding east-west ratio was hence 10 percentage points lower last year than that of the agreed pay rates. At a ratio of 76 %, compared with less than 50 % in 1991, the relative increase in the cost of labour services was nevertheless still very high. In relationship to fixed capital, which is often heavily subsidised in the new Länder, the relative factor prices are likely to have shifted even more sharply to the detriment of the factor labour.

Net wages and salaries east/west

For wage and salary earners, this trend was accompanied by higher job insecurity and hence also risk to income. There has been a marked improvement in the material circumstances of those who remain active in the workforce, however. In net terms, i.e. after deducting wage tax and employees' contributions to social security funds, the income ratio in 1996 – measured by the west German standard – was already 84 %, compared with 55 % in 1991. What was significant in this respect was that the "gap" between the east and west, which still exists, means that the fiscal inroads made by the progressive rate of income tax are not as great. Furthermore, the purchasing power of disposable income benefited from the fact that the new Länder have a considerable price advantage owing to lower rents in many cases and the marked price differential in services, which probably cannot be explained solely in terms of the differing nature of the goods and services that are consumed.

Labour costs in a temporal and regional analysis

Compensation and non-wage labour costs

The increasing burden of social insurance contributions is also likely to have played a part in the efforts of enterprises in both eastern and western Germany not to allow wages and salaries to rise to the same extent as the agreed pay rates. That is because, ultimately, compensation containing the employer's share in social insurance contributions in addition to wages and salaries is, from the employer's point of view, the relevant cost and decision variable with regard to the production factor labour. On account of the increased contribution rates to social security funds, these statutory labour costs, at 6 ¼ %, have risen annually by 1¾ percentage points more than actual earnings. For that reason, too, the gap between compenstion and net wages and salaries has increased further during the past few years. In 1991, net wages and salaries were 55 ¾ % of compensation, compared with no more than 52 ½ % in 1996.[4]

East German firms were particularly severely affected by the increase in social insurance contributions since, in their case, the share of wages in value added is generally comparatively high and the shifting potential in sales prices, particularly in nationwide markets, is

4 It should be borne in mind in this context that the sharp increase in net wages and salaries in 1996 was due not only to the exemption of subsistance incomes from income tax but also to the reclassification of child benefit in the national accounts and is therefore, in part, of a purely statistical nature. Moreover, tax refunds to wage and salary earners impinged on the level of assessed income tax and not on wage tax. For more details, see Deutsche Bundesbank, Recent tax revenue trends, Monthly Report, August 1997, page 83 ff.

Compensation, taxes and levies, and take-home pay *

Germany

Year/Period	Compensation of employees	Employers' contributions to social security funds	Average gross wage and salary	Deductions (wage tax and employees' contributions to social security funds)	Average net wage and salary
	DM thousand				
1991	48.6	9.0	39.6	12.5	27.1
1992	53.8	10.0	43.8	14.3	29.4
1993	56.1	10.3	45.8	14.9	30.8
1994	58.0	11.2	48.9	15.9	31.0
1995 p	60.3	11.8	48.5	17.3	31.2
1996 p	61.8	12.2	49.5	17.1	32.4
	as % of compensation				
1991	100	18.5	81.5	25.7	55.8
1992	100	18.6	81.4	26.7	54.8
1993	100	18.4	81.6	26.6	55.0
1994	100	19.3	80.7	27.4	53.4
1995 p	100	19.6	80.4	28.7	51.7
1996 p	100	19.8	80.2	27.8	52.4
	change from previous year in %				
1992	10.6	11.1	10.5	14.8	8.5
1993	4.3	3.3	4.6	4.1	4.8
1994	3.5	8.3	2.4	6.4	0.5
1995 p	3.9	5.5	3.5	9.0	0.7
1996 p	2.4	3.6	2.1	– 0.9	3.8
1991 – 1995 1	5.5	7.0	5.2	8.5	3.6
1991 – 1996 1	4.9	6.3	4.6	6.6	3.6

***** Per employee in Germany. — **1** Annual average change in %.

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likely to be no more than very limited. Moreover, despite some signs of improvement, the income and financing power of many enterprises must still be rated as weak; even small additional cost burdens can lead very quickly to serious profitability and liquidity difficulties. In general, it should also be pointed out that an increasing weight of statutorily fixed non-wage labour costs impairs the flexibility of the entire block of labour costs.

Labour productivity

How much is appropriate, or still affordable, in terms of production costs must be judged by the profitability of the production factors involved in the value-added process. Their respective contribution to the production process can be precisely determined only theoretically. The labour productivity which is calculated statistically, for example, is only an inadequate measurement of this and can even be misleading if greater numbers of employees are made redundant as a result of excessive labour costs. In that way, a factor price which is initially not in line with market conditions can attain its matching labour productivity, which is then shown as a rate of pay which conforms with productivity in an ex post analysis. Bearing that in mind and comparing the quantitative rise in labour costs with the growth in labour productivity in the period between 1991 and 1996, it nevertheless becomes apparent for Germany as a whole that wages considerably outpaced productivity. That applies in particular to the years up to 1993; after that, the rise in aggregate unit labour costs was moderate or the level declined slightly, although this did not even remotely offset the preceding surge in costs. This finding applies to both western and eastern Germany, even though the discrepancy between labour costs and labour productivity was much greater in the new Länder.

In 1996, east German nominal gross domestic product per employed person was no more than 59 % of the west German level. However, since the difference in terms of compensation per employee had already fallen to 73 %, the aggregate labour costs per nominal unit of value added in eastern Germany were around one-quarter higher than in the old Länder. Although there was a marked reduction of the gap between labour costs compared with 1991, virtually no further progress has been made since 1994 in terms of this key cost variable for the competitiveness of east German enterprises.

Unit labour costs comparison

The objection has often been made to a labour costs comparison of this kind that this indicator covers only one part of the costs and that systematic bias cannot be ruled out. It is said to be conceivable that an economy such as the east German one (in which compensation per employee was around one-quarter lower than in western Germany in the past year) can quite easily have comparative costs advantages in less capital-intensive production. If enterprises can choose between different production technologies, for instance, it is possible – assuming equally high prices for capital goods in eastern and western Germany – that less capital-intensive production technology would be competitive, too. Therefore, the possibility cannot be ruled out that the earnings position is not less favourable than in the west, although labour costs per nominal unit of value added are higher.

The line of reasoning is correct insofar as the unit labour costs (in the widely used definition) are, ultimately, no more than a slightly modified version of labour's aggregate share in the national income; it is not possible to draw an automatic conclusion on a gap in profitability, especially in the corporate sector, from a regional comparison of this alone. It is also correct that the level of aggregate labour costs depends on the state of the available production technology and the importance of the individual sectors of the economy. Regions with differing industrial and production structures are hence likely to differ in their (optimum) cost profile as well.[5] A global and isolated comparison of unit labour costs is therefore inadequate for an overall assessment of corporate competitiveness.

Average unit costs

What is more instructive is a regional comparison of total average costs. Combining labour costs and the capital user costs for that purpose,[6] it being possible to determine the latter only approximately, produces a substantial cost overhang in comparison with nominal value added for east German producing enterprises in 1991. This indicates appreciable losses in the operating result. The aver-

5 For example, in the new Länder, the construction industry (which is comparatively labour-intensive in its production) has a share of 12 % in total real value added, i. e. a weight which is more than twice as high as in western Germany.
6 In order to derive a corporate sector which – notwithstanding individual differences – is as homogeneous as possible, it is advisable to adjust the aggregate variables for data on the public sector, households, letting of dwellings and the financial institutions.

age costs were thus more than two-fifths higher than in the old Länder. Although the gap distinctly narrowed in the years that followed, there has been a relative deterioration again since 1995. According to these calculations, last year the comparable west German level was exceeded by almost three-tenths.

Conclusion

An inadequate overall level of competitiveness on the part of east German producing enterprises is hence confirmed by an analysis of the average aggregate costs of the producing enterprises as it is by a comparison of the unit labour costs. In the new Länder, the major obstacle to a radical improvement in competitiveness, apart from many long-term "historic" problems and the falling away of traditional markets in eastern Europe and the former Soviet Union, was the massive increase in the cost of the factor labour. Between 1991 and 1996, labour costs per hour worked in eastern Germany went up by 66 %, which is around three times more than in the case of the west German producing enterprises. The strategic role of this cost factor is additionally emphasised if the difficulties in the output and input markets as well as organisational shortcomings are also taken into consideration. Under those conditions, many enterprises had no option other than to pursue defensive adjustment strategies, resulting in rationalisation profits due to redundancies, trends towards specialisation and a decline in the binding force of industry-wide wage bargaining.

Leeway for distribution and wage trend

Distribution yardstick

In a highly developed and open economy such as the German one, a non-inflationary wage rate policy should, in principle, be geared over the medium term to the real leeway that is available for wage increases. In macroeconomic terms, this is chiefly determined by the growth in domestically produced goods and services. In addition, the expenditure that is needed for maintaining the overall capital stock is also important. Moreover, changes in the terms of trade and current (unrequited) net transfers abroad must be taken into account, since both redistribution processes can ultimately narrow or broaden the remaining domestic leeway for income distribution that is neutral in terms of inflation.[7] The key precondition in the norm which is specified in this way is a state of high employment. The more an economy fails to achieve that objective, the more the average rises in real wages must remain below that yardstick – without it being possible, admittedly, to quantify with sufficient accuracy the level of wages that is consistent with market conditions.

Leeway for distribution

In line with that approach, the leeway for distribution in united Germany increased by no more than 5 ¼ %, or an annual average of 1%, between 1991 and 1996. This is a weak rise in comparison with conditions in western Germany in the eighties. Firstly, it reflects the steep downturn in economic activity in 1993,

7 For a detailed explanation of this, see Deutsche Bundesbank, The trend in agreed pay rates and actual earnings since the mid-eighties, Monthly Report, August 1994, page 37 f.

Trend in the real overall leeway for distribution and its components

Germany

Year	Overall leeway for distribution at 1991 prices: DM billion	Overall leeway for distribution at 1991 prices: Change from previous year in %	Contribution from: Net domestic product	Contribution from: Terms of trade	Contribution from: Balance of current transfers 1
			Percentage points 2		
1992	2,522.4	2.5	1.8	0.7	– 0.0
1993	2,463.8	– 2.3	– 2.0	0.4	– 0.7
1994	2,520.0	2.3	2.7	0.1	– 0.5
1995 p	2,568.9	1.9	1.7	0.4	– 0.2
1996 p	2,590.3	0.8	1.2	– 0.2	– 0.2

1 With the rest of the world. — 2 Discrepancies in the totals are due to rounding.

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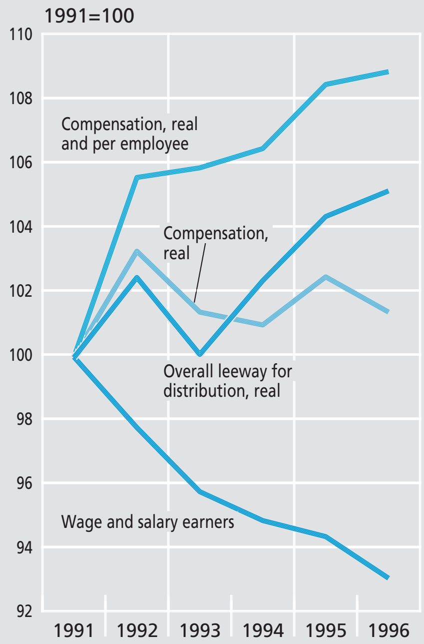
which left a deep mark mainly in the old Länder. At that time, the real net domestic product in Germany fell by 2 %. Secondly, it is also a reflection of the sluggish trend in growth and the difficulties in putting reconstruction in eastern Germany on a self-sustaining basis. As a result of the improvement in the terms of trade which accompanied the appreciation of the Deutsche Mark (up to 1995), the real leeway for distribution in the period under review expanded by a total of 1½ %. However, on balance, this gain was almost completely lost as a result of the current transfers abroad, which signify a drain on the assets that would otherwise be available domestically for distribution. With the depreciation of the Deutsche Mark, there is likely to be a considerable deterioration in the terms of trade this year, which implies a corresponding "advance distribution" abroad.

Pay policy behaviour

Management and industry were initially hesitant in taking account of the – as described above – comparatively weak increase in the leeway for distribution. The 1991 and 1992 pay rounds were still marked by the excessive settlements in the wake of the German "unification boom", for example. Between 1991 and 1996, real compensation per employee in Germany (which are deflated by the price index for private consumption) went up by a total of 9 % or an average of 1¾ %, and hence much more than the real margin available for wage increases. Since the reorientation in wage rate policy that was initiated in western Germany in 1993, however, the conditions for creating new cost-effective jobs have increasingly improved. The effects of the return to moderate wage settlements on overall labour costs were lessened, however, by the sharp rise in enterprises' statutory non-wage labour costs. This was due – as explained above – to the raising of the contribution rates to social security funds. In purely mathematical terms, this means that, on an average of each of the past four years, just over ¼ percentage point or almost half of the (already) modest growth in the leeway for distribution was used. This trend has continued to accelerate in 1997, mainly because of the renewed increase in the employers' contributions to the pension insurance scheme.

The hoped-for employment effects of a moderate wage policy only become apparent over the medium term. In the eighties, for ex-

Overall leeway for distribution and wage trend *



* Work-place concept.

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ample, when the number of employed in western Germany increased by just over two million persons between 1982 and 1990, the rise in real incomes was 1½ percentage points lower on an annual average than the expansion of the leeway available for wage increases. The present high level of unemployment therefore calls for a continuation of the course that has been embarked on during the past few years.

Requirements for more employment and income

Economic policy priorities

One of the most important tasks of economic policy in the years to come will consist in expanding employment opportunities and in reducing the high level of unemployment which is unacceptable in the long term. Herein lies the key to more labour income overall. What is needed for this is a strengthening of the forces of growth in the whole economy. Of chief importance in this context will be the structuring of underlying conditions to make investment in Germany profitable – above all, in new fixed assets but also in human capital – not only in comparison with financial assets but also in relationship to alternative production centres abroad. Reform measures will achieve their full effect, however, only if they are well coordinated and are applied consistently over the long term; this, too, is a lesson to be learned from the experience of successful reform policies in other countries as well as from the positive example of the eighties in Germany. Wage and social policies are closely interlinked. Precisely the problems associated with non-wage labour costs have shown that both should be understood as a whole in terms of incentive and distribution effects.

Pay policy responsibility

Ensuring moderate pay rises over a number of years is the challenge facing management and labour. A lasting strengthening of "mass purchasing power" cannot be decreed at the negotiating table; given the existing problematic situation, this must and can succeed only by increasing the number of jobs that are cost-effective under competitive conditions. A strengthening of "mass purchasing power" which tends to be "paid for" by cost effects cannot, on the other hand, improve the supply of jobs in the economy as a whole. The collective pay agreements of the past few years point in the right direction, although the impact of the pay settlements is being contained by additional statutory costs in 1997, too. Besides moderate wage settlements, greater flexibility – both in working hours and in the pay component – is to be especially welcomed. Supplementing that, a greater differentiation of wages and salaries in terms of skills would be helpful. That could improve employment opportunities, above all, for that group of persons which has been particularly hard hit by structural change. Finally, there is also the challenge to Parliament to make a lasting and substantial reduction in the "wedge" of taxes and levies between the producer and the consumer wage, i. e. the gap between gross income and net earnings.